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SUBJECT: CRIMEAN ECONOMIC DEVELOPMENT CONSTRAINED BY LACK
OF FUNDS

[11.](#) (U) Summary: The global economic crisis has not spared
Crimea, where unemployment was at 8% from January through
March 2009, up from 4.7% in 2008. Local tourism has
experienced a 14% decline since 2008, and industrial output

dropped 21.6% in that same period, with production at some
plants dropping up to 90% due to lack of demand. The fortunes
of Crimea's agricultural sector remain largely tied to its
tourism industry, with the majority of local produce consumed
at the seaside resorts. The Government of the Autonomous
Republic of Crimea (GARC) acknowledges that they must improve
the investment climate and local infrastructure, but many
local initiatives have been stalled by lack of funds. Even
if funding were available, the GARC complains that, in many
instances, national GOU restrictions limit their ability to
offer competitive investment incentives. End Summary.

Business Climate

[12.](#) (U) Of the 281 large companies operating in Crimea, 80%
are operating in the agricultural and manufacturing sectors,
15% in trading, and the remainder are a mix of scientific and
transportation firms. The Government of the Autonomous
Republic of Crimea (GARC) supports entrepreneurship efforts,
and has authorized the establishment of a network of 15 "one
stop shops" where government employees assist business owners
in filling out forms and applying for licenses, but at
present only one is staffed and providing services, while the
rest lack operational funds. USAID is supporting these
establishments by providing office equipment. The GARC has
also authorized the creation of five business incubators,
where start-up firms can get cheap office space and access to
office equipment until they become successful enough to move
into their own premises. However, as with the one-stop
shops, only one incubator is presently funded and operating
due to budget shortfalls.

[13.](#) (U) Despite the GARC's efforts to improve the business
climate, businesses report numerous problems, including that
VAT refunds are often delayed for months, if not years, and
getting certificates for export is an expensive, lengthy
process.

Tourism and Recreation

[14.](#) (U) Accounting for 7% of the GARC's budget revenue,
income from tourism in 2009 is down 20% from 2008 levels,
according to the Mayor of Yalta and the Ministry of Economy
of Crimea. This contrasts with figures from 1998, when
tourism revenue accounted for one third of the GARC's
budget. Crimea's tourism and recreation industry is
concentrated on its southern coastline around the city of
Yalta, where the subtropical climate and Black Sea attract an
estimated one million visitors per year. There are forty
sanatoriums, hotels and resorts, providing roughly 40,000
guest accommodations, one third of which have been renovated
to international hospitality standards. Thirteen airlines
serve the airport at Simferopol, with direct flights from

Ukraine, Russia, Germany, Uzbekistan and Turkey. There are five main sectors - spa/healing; business conferences; wine tourism; cruises; and active tourism (climbing, kite sailing, cycling and horseback riding). The cruise sector has been experiencing slight, but steady, growth in recent years. 120 ships made one-day port calls in Yalta in 2008, with two or three ships arriving per day during the high season.

¶5. (U) The majority (80%) of Crimea's visitors are Ukrainians. Only 10% of visitors were from foreign countries in 1998, rising from 2% in 1992. Russians make up 26% of foreign tourists, followed by Poles (25%), Moldovans (17%) and Byelorussians (12%), with 20% coming from other countries. Prior to the economic crisis, the Ukrainian middle class made up a large part of Crimea's tourism sector, especially during the boom years from 2006 to 2008. However, with the economic crisis, fewer middle-class Ukrainians are vacationing and those that are travelling are staying in less expensive accommodations. The number of tourists staying at hotels in Crimea dropped 14% since 2008, but GARC analysts surmise that the number of tourists may not have actually fallen at the same rate. Crimea's hotels have responded to the crisis by raising room rates, resulting in significant vacancy levels as budget-conscious travelers seek alternative lodgings, such as unofficial guest rooms or tents on the beach. Many informal tourism service providers, including bed and breakfasts and local residents offering spare rooms, are not declaring income or paying taxes, preventing the GARC from getting an accurate count of visitors. Yalta, in particular, has seen its budget revenue fall 20% since 2008, due both to lost tourism revenue and the stoppage of 100 out of 120 leisure industry construction projects with the onset of the crisis. Yalta's budget has further been impacted by the Government of Ukraine's (GOU) ban on gambling enacted in June 2009, which has cost them more than UAH 5 million (USD

600,000) in lost revenue.

¶6. (U) GARC analysts expect that the tourism industry in Crimea will remain depressed in 2010, but do not expect the downturn to last for long beyond that. They acknowledge that the infrastructure will need to be upgraded significantly, additional recreation facilities must be developed (land has been set aside for a dinosaur-themed amusement park), and the region's reputation for 'Soviet-style' service has to be overcome if Crimea is to compete against other tourist destinations in the Black Sea region.

Agriculture

¶7. (U) Although risky in Crimea due to frequent early frosts and droughts, agricultural activity makes up 60% of Crimea's GDP. Much of the center of the Crimean peninsula is sown with traditional crops - Durham wheat, barley, rapeseed, vegetables, apples and grapes - which are frequently planted and harvested without the benefit of modern technologies. Crimea has found a profitable outlet for its wheat, which is exported to Italy for processing, and the amount of acreage under grain crops has been increasing at the expense of vineyards and fruit orchards. Almost all of Crimea's food crops are consumed locally, with much of the demand coming from the tourism industry on the south coast. Despite the decline in tourism, Crimean agricultural output grew 5.5% year-on-year from Jan-July 2008 to 2009, with surplus production being exported.

¶8. (U) Crimean wineries account for the majority of Ukraine's annual production of 1.5 billion liters of wine. For its part, foreign demand for Crimean wine has held steady at 160-200 thousand liters per year, through the crisis. 90% of Crimean wine exports go to Russia, and 5% to Belarus. Less than 1% reaches the U.S. markets. In the 1980s, Crimea had 180,000 hectares planted in vineyards, but in 1986, Mikhail Gorbachev's anti-alcoholism campaign saw 80,000 hectares ripped out, and the production of sweet dessert wines and cognac was greatly diminished until the breakup of the USSR. Since independence, 140,000 hectares of vineyards have been replanted, and many of the wineries of Crimea have switched to making the dry wines that are popular with both foreign customers and Kyiv elites.

Energy

19. (U) Most of Crimea's energy comes from power plants in the mainland of Ukraine, coming in across an increasingly overburdened electrical grid. To cut costs and lower the load on the power grid, the GARC is promoting energy efficiency among the peninsula's industries, building on the 2001 "Clean Energy for Crimea" exchange program with Washington State. The GARC is working on overcoming obstacles to investment in wind energy and promoting a joint venture between Crimea and Washington businesses for the manufacture and sale of renewable energy equipment. Local thermal power plants produce 6-7% of the electricity used in Crimea, although the GARC has expressed interest in investing more heavily in alternative energy - solar, wind and additional thermal pumps. However, lack of funding and capacity to attract foreign investment has hampered efforts in this area.

Manufacturing

10. (U) Crimea's manufacturing sector is concentrated in the chemical and machine building industries, mostly situated in the northern part of the peninsula. The global economic crisis and resultant reduction in industrial demand has severely impacted Crimea's machine building sector, and the lack of customers has led to production cutbacks of up to 90% at some firms. Overall, Crimea's industrial output fell 26.1% year-on-year from H1 2008 to H1 2009.

Investment

11. (U) The majority of foreign direct investment (FDI) in Crimea goes into agriculture, industry and recreation. As of July 1, 2009, FDI stood at USD 673 million, with annual inflow growing from USD 20.9 million in 2002 to USD 51.1 million in 2008. The GARC Ministry of Economy estimates that one third comes from Russia, one third from the European Union, and one third from the rest of the world. Even in the "autonomous" region, Crimean authorities have little freedom to offer investment incentives, due to limits set at the national level in 2005. Permitted incentives include tax-free import of construction equipment used for development, rebates of VAT payments, and a property tax holiday during the process of construction. Due to a country-wide ban on the sale of agricultural land, foreign firms have adopted the practice of signing 49-year leases.

Comment

12. (SBU) Comment: Crimea's prospects for economic development are limited in the near term. The GARC has created the legal and administrative bases for future progress, but their initiatives lack funding and have little impact on Crimea's business and investment climate at the present time. They acknowledge the peninsula's underdeveloped power and transportation infrastructure and the difficulties faced by potential entrepreneurs, but the GARC lacks the financial resources to address these issues at the present time and is further restricted by GOU legislation which limits the ability of local governments to offer investment incentives. Widespread tax evasion also constrains the GARC's ability to address the peninsula's development. End comment.
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